BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

I.

The Opinions of the Courts Below

The opinion of the United States Circuit Court of Appeals for the Third Circuit was rendered on April 1, 1941. It is reported in 119 F. (2d) 94, and is to be found on pages 7 to 13 of the record herein.

The opinion of the United States Board of Tax Appeals is reported in (1940) 40 B. T. A. 758, and appears on pages 1 to 5 of the record herein.

II.

Jurisdiction

1. The statutory provision believed to sustain jurisdiction is Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (c. 229, sec. 1; 43 Stat. 938).

2. The judgments sought to be reviewed were entered on April 1, 1941 (R. 13).

3. The proceeding in which review was sought was initiated in the United States Board of Tax Appeals. It involves the liability of the petitioner for income taxes under section 167 (a) (2) of the Revenue Act of 1934 on income of a trust created by her. The United States Board of Tax Appeals found for the petitioner and against the government and denied the deficiency assessments. Upon petition for review, the United States Circuit Court of Appeals for the Third Circuit reversed the United States Board of Tax Appeals and entered judgment for the Commissioner of Internal Revenue.

III.

Statement of the Case

A full statement of the case has been given under heading "A" in the petition and in the interest of brevity is not repeated.

IV.

Specification of Errors

The United States Circuit Court of Appeals for the Third Circuit erred in the following respects:

1. In holding that Olaus W. Caspersen, the trustee under the deed of trust involved in this proceeding and the husband of the petitioner, had no interest in the disposition of the income of said trust substantially adverse to that of the petitioner because it erroneously applied the laws of the State of New Jersey.

2. In failing to determine that section 167 (a) (2) of the Revenue Act of 1934 is unconstitutional if construed to require the taxing as petitioner's income of income of said trust, the distribution of which was not subject to her control and no part of which was distributed to nor accumulated for her nor applied nor applicable to the discharge of her obligations, where it is not necessary to prevent tax evasion, nor is there an equivalence.

V.

ARGUMENT

POINT I

Olaus W. Caspersen, the husband-trustee, was possessed of a substantial adverse interest in the disposition of the trust income in question.

The principal question presented is whether Olaus W. Caspersen, trustee and husband of the petitioner, had an interest substantially adverse to the petitioner in the disposition of the trust income.

Section 167 of the Revenue Act of 1934, 48 Stat. 729, 26 U. S. C. A. 167, provides:

> "(a) Where any part of the income of a trust
>
> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor:
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

It is the contention of the petitioner that her husband, Olaus W. Caspersen, possessed a substantial adverse interest within the intendment of the statute. The husband-trustee had a legal duty to support their minor child; he also had a duty to support *his* blood relatives as required by New Jersey law and permitted by the trust instrument.

This Honorable Court has decided that the federal courts cannot set up an independent federal, general or common law except

> "in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State . . . There is no federal

> general common law . . . And no clause in the Constitution purports to confer such a power upon the federal courts." *Erie Railroad Company* v. *Tompkins,* (1938) 304 U. S. 64, 58 S. Ct. 817.

The federal courts are not entitled to decide what state law *ought* to be, they must determine what the state law *actually is. Klaxon* v. *Stentor,* decided June 2, 1941, No. 741, reported in *The United States Law Week* for June 3, 1941, Vol. 9, Sec. 4, page 4380.

The United States Board of Tax Appeals held that the trustee had a substantial adverse interest in the trust because of his duty to support the child. The United States Circuit Court of Appeals for the Third Circuit reversed this decision on the grounds that the mother had a similar duty.

Under New Jersey law the mother of a minor child is liable to support that child, *only* where the father fails to do so. The duty of support rests primarily on the father; it is only in the event that he cannot do so that the mother is liable for such support. New Jersey law goes far in imposing the duty of support of minor children on the "man" of the family. It even holds that

> "The provision of this section (imposing duty of support) shall apply to the minor children of a mother whose husband shall fail properly to support and maintain such children when by reason thereof they are likely to become a public charge upon the municipality in which they have gained a legal settlement." *New Jersey Statutes Annotated, Title* 44:1-140.

See also *In re Ganey,* (1921) 93 N. J. Eq. 389, 116 Atl. 19; *Alling* v. *Alling* (1894) 52 N. J. Eq. 92, 27 Atl. 655.

Therefore, the United States Circuit Court of Appeals for the Third Circuit erred in holding that the husband-trustee had no substantial adverse interest in the trust because of his duty to support the child, as the mother was

also liable. The Court misinterpreted the New Jersey law and disregarded the rule that the father is solely liable, the mother being liable only in the event that the father fails. The federal courts cannot interpret state law by what they believe it should be; they must interpret state law as it is. *Klaxon* v. *Stentor*, decided June 2, 1941, No. 741, reported in *The United States Law Week* for June 3, 1941, Vol. 9, Sec. 4, page 4380.

Moreover, the United States Circuit Court of Appeals for the Third Circuit did not consider whether the duty of the trustee to support his mother and other blood relatives as required by New Jersey law was a substantial adverse interest.

> "The father, grandfather, mother, grandmother, children, grandchildren, and husband or wife, severally and respectively, of a poor, old, blind, lame or impotent person or other poor person or child not able to work, shall, if of sufficient ability, at his or their charge and expense, relieve and maintain the poor person or child in such manner as the overseer of the poor shall order, or the court upon its own initiative or the information of any person, after notice to the person or persons chargeable and hearing the overseer, may so order." *New Jersey Statutes Annotated*, Title 44:1-140.

The settlor was under no legal duty to support the mother of the husband-trustee, as there was no blood relationship between them as required by the New Jersey statute. On the other hand, not only did the husband-trustee have a legal duty to do so, but also, acting under the provisions of the trust, he did support his mother from the trust income. It cannot be held, therefore, that the husband-trustee had no substantial adverse interest in the trust because of his duty to support his mother on the grounds that a settlor of the trust had a similar duty; in fact and in law the settlor had no duty to support the blood relatives of her husband. In so holding the United States Circuit Court of

Appeals for the Third Circuit erred in its determination of the law of New Jersey.

> "There may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider questions of law which were neither pressed nor passed upon by the court or administrative agency below. *Hormel* v. *Helvering*, Law Ed. Advance Opinions, rendered March 31, 1941, Vol. 85, page 651 at 654.

But this is not a fresh issue raised for the first time in this petition; it was presented before the United States Board of Tax Appeals and the United States Circuit Court of Appeals for the Third Circuit. This point was made in the brief below and orally presented in the argument before the Court.

Congress has not defined the term "substantial adverse interest" as used in the statute. The Congressional purpose, however, was to block a possible means of tax avoidance by the device of vesting the power to distribute the income in some person having no stake in the trust or a stake so insubstantial that the holder of the power would not improbably be amenable to the grantor's wishes. (*Fulham* v. *Commissioner*, (1940) 110 F. (2d) 916).

The statute is aimed at immorality. A situation truly condemned and sought to be reached by it can only arise where the grantor, ostensibly relinquishing the right to income, chooses someone as trustee who will acquiesce in his wishes to the end that he may, in fact, receive or retain that which apparently he is giving away. The statute is not aimed at a trust created for a legitimate purpose.

Whether a trust falls within the scope of the statute must be determined upon an appraisal of the trust instrument against a background of realities (*Fulham* v. *Commissioner*, supra); in the light of the settlor's intention in creating the trust and the course of conduct subsequent

to its creation (*Commissioner* v. *Morton*, (1940) 108 F. 2d) 1005; *Henry A. B. Dunning*, (1937) 36 B. T. A. 1222; *Raoul H. Fleischmann* v. *Commissioner*, (1939) 40 B. T. A. 672.

POINT II

Section 167 (a) (2) of the Revenue Act of 1934 is unconstitutional if it be construed to require taxation to the grantor of trust income which is neither distributed to nor accumulated for her nor applied nor applicable to the discharge of her obligations, and the distribution of which is not subject to her control, because it is not necessary to prevent tax evasion, nor is there an equivalence.

Congress has the power to adopt means fairly and reasonably calculated to prevent the avoidance of taxation. Nevertheless, the provisions of the statute adopted may be so arbitrary and capricious as to amount to confiscation and thereby offend the Fifth Amendment to the Constitution (*Heiner* v. *Donnan*, (1932) 285 U. S. 312, 52 S. Ct. 358). There are limits to the power of Congress to create a fictitious status under the guise of supposed necessity (*Helvering* v. *City Bank Farmers Trust Co.*, (1935) 296 U. S. 85, 36 S. Ct. 70). It is not necessary to tax the petitioner here to prevent tax avoidance.

A tax may be levied where the person called upon to pay the tax received a benefit substantially similar to a benefit received by other persons who are within the scope of the normal operation of the same tax statute, but where there is no equivalence the "lawmakers have done a wholly arbitrary thing" and "laid a burden unrelated to privilege or benefit" (*Burnett* v. *Wells*, (1933) 289 U. S. 670, 53 S. Ct. 761).

The effect of this statute, if applied to the petitioner, would be to find "equivalence where there was none nor anything approaching it" and to lay "a burden unrelated to privilege or benefit" (*Burnett* v. *Wells*, supra).

The decision of the Supreme Court in *Hoeper* v. *Tax Commission*, (1931) 284 U. S. 206, 52 S. Ct. 120, holding a statute unconstitutional which attempted to levy a tax on a husband, based upon the combined income of both husband and wife, points to the unconstitutionality of Section 167 (a) (2) if construed to compel taxation to the petitioners of income of the trust actually distributed to others. To the same effect are *Schlesinger* v. *Wisconsin*, (1926) 270 U. S. 230, 46 S. Ct. 260, and *Bowers* v. *Kerbaugh-Empire Co.*, (1926) 271 U. S. 170, 46 S. Ct. 449, and the dissenting opinion in *Charles H. Mott* v. *Commissioner*, (1934) 30 B. T. A. 1040.

CONCLUSION

It is respectfully submitted that this case calls for the exercise by this Court of its supervisory powers in order that the construction and constitutionality of the federal statutes involved be definitely determined and the errors of the Circuit Court of Appeals for the Third Circuit in determining the laws of New Jersey be corrected, and that, to such end, writ of certiorari should be granted and the court should review the decision of the United States Circuit Court of Appeals for the Third Circuit and finally reverse it.

Dated, June 26, 1941.

JACKSON R. COLLINS
Counsel for Petitioner